GUY COHEN

Trading with the OVI and Flag Patterns

3rd Edition: Includes Automated Trading Chapter



OVI TRADERS

TRADE WHAT YOU SEE AND FOLLOW THE INSIDERS

Introduction

I write the new 2014 edition of this book with real excitement and professional satisfaction. My systems have evolved to institutional standards of quality, measurability and performance. This is now statistically proven, which I will outline later in this eBook.

My Focused Approach to Trading is Independently Proven

Having a focused approach will pay you dividends over the medium to long term. Unlike most people out there I have focused on the same thing for many years, creating consistently outstanding results for me and my students, and making regular incremental improvements.

My principle trading approach involves three simple steps which has made millions of dollars for traders all around the world:

1. My OVI indicator reveals the market **direction**
2. Flag patterns enable optimal **timing**
3. My trading plan provides **safety** while aiming for windfall profits

If you're not familiar with the terms just mentioned, don't worry. All will be revealed during this eBook. The important message is that my method is simple to operate, it's enshrined in reality and it's proven. Yes, there is sophistication inside - just like inside an iPad - but it is very simple to use – just like an iPad!

Also worth noting:

- The OVI is now statistically proven to improve trading performance and outperforming the S&P all on its own.

- In combination with basic chart setups and trade management the OVI becomes even more powerful ... again, statistically proven by independent hedge fund analysts.

Knowing that the stats are overwhelmingly on my side I can now enjoy trading far more than ever before. And so can you ... provided you follow the formula.

From ‘Guided Discretionary’ to Automated Trading Signals

Until the past year or so I was always a ‘guided discretionary’ trader. This means having a strict set of rules to trade by, but the ultimate selection has an element of discretion.

To enhance my highly focused style of trading I developed state-of-the art filters to make it easy and efficient to identify the best stocks to trade. This resulted in a loyal following of traders who continue to report phenomenal results.

My successful students come from all over the world, they have widely varying account sizes and experience levels. So, no matter what your account size or experience level, I can help you become a more successful trader.

I’ve mentioned that my approach is very focused. The final say however is in the hands of the individual trader. My job is to teach you the method, and how to use my tools for maximum efficiency and best results.

Due to the uniqueness of my method, and the proprietary indicator that we use (the OVI), an increasing number of my members now come from institutional backgrounds, discovering that my methods have complemented or superseded their own. As I got to know these new members it became clear that they wanted more automation.

The fact is that institutions and hedge funds demand more automation with their trading activities so the systems can be rigorously tested, and so performance can be more accurately anticipated.

So a couple of years ago I undertook the challenge to conduct automated testing in a professional environment. The big question was: *would the thousands of trades and observations I'd made over the years be statistically validated by a server that would objectively analyse millions of combinations and permutations*?

To cut a long story short – and to my utter relief - the answer was a resounding yes. Not only that, but the parameters I had observed to work best over many years, were virtually the same parameters that gave the best performance when objectively tested in lab conditions. So, as I write this new edition in 2014, I am humbled to say **the OVI-Flag combination has now been statistically proven by independent hedge fund analysts**.

From a professional point of view this has been the most satisfying achievement. To know that a machine could objectively deliver outstanding results from my subjective observations, algorithms and work conducted over many years. It also means that cold statistics verify what my team and I have been observing and saying for years.

Stocks Can Give You an Edge Like No Other Instrument

The stock market is the greatest financial instrument for wealth creation. This is why the likes of Warren Buffet and William O'Neil have focused their careers in it.

The stock market is the most suitable market to be traded by regular traders just like you. The reason is because unlike the other markets, it really is possible for the amateur trader to gain an edge in the stock market. My edge is my proprietary indicator which is now independently proven ... and it can be your edge too.

I'll be talking more about this during a special webinar where you'll see a live demonstration of my OVI-Flag combo method. I'll also be revealing the newest version of the **OVIcopilot** which is my automated trading system. The OVIcopilot enables you to benefit from my method in minutes each day. It really is phenomenal, it's been thoroughly tested to institutional standards and unequivocally endorsed by independent hedge fund analysts.

If you're reading this, then you should have already registered for the webinar I'm holding on Thursday 12th June 2014.

The Three Types of Trader

Regardless of account size or experience, there are three distinct types of trader. See which one(s) you are:

1. The trader who likes to trade familiar stocks, make their own decisions and get things done in ten or so minutes every day.
2. The trader who has more time to do some more detailed research and be selective about what they are trading. This trader has say 20-60 minutes on a given a day.
3. The trader who is happy to blindly follow a reliable signal and wants the process to take only 5-minutes per day.

If you're anything like me you'll have recognised yourself as all three characters. I can be all three of those characters at different times! Sharing the same human traits, you and I are likely to be very similar.

- We like to understand the method we're trading
- We like to follow stocks we're familiar with
- We like to follow a simple signal; and
- From time to time we enjoy taking more time over more detailed manual research.

In this eBook, I'll cover the basic method itself in Chapters 2-4, and in Chapter 5 I'll go into the advantages and disadvantages of more automation. If you're like me and my students, then the combination of part discretionary trading and part automated trading will be the most appealing.

For now, I'm going to summarize my unique method.

Trade Safely in Three Easy Steps

In this report I'm going to show you how to trade safely and for windfall profits in just three easy steps.

My method embraces one of the most respected traditional techniques combined with a unique way of **truly** following insider trading activity – this is borne out by statistical research. These techniques are meshed together into a simple trading plan that anyone can replicate. My method is endorsed by professional traders who not only subscribe to my unique services, but also use my tools to qualify their own stock selections.

Dramatic Trades That Demonstrate What We Do Best

Just to whet your appetite I'm going to mention a few trades that illustrate the power of what I do and how simple it is. To give you some history of how this came about, since the year 2000 I would regularly glance at options chains when analyzing stocks to trade, with great success. My method took a major leap forward when I observed this particular turn of events:

Bear Stearns (BSC) 2008

Between 1st January 2008 and 28th February 2008, Bear Stearns (BSC) shares traded in a range between $68.18 and $93.09. Nothing unusual in that.

On 3rd March 2008 Bear Stearns closed at $77.32. At around this time most commentators (famously including those on CNBC) were suggesting that BSC could be a takeover target and as such were optimistic about the stock's prospects.



At the same time, a discreet new indicator plummeted to its lowest possible reading for BSC. In itself that wasn't the key factor. It's the fact that for the next two weeks the indicator remained at its most negative reading for all but two days.

Exactly two weeks after the unknown indicator first plummeted, BSC went into free-fall, reaching a low of $2.84. Bear Stearns was indeed taken over … but at $10 per share, a far cry from the heady heights of $77.32.

The share price drop represented a move of over 80% and a massive profit for those who had bet on BSC's demise.



This was one of the most dramatic declines in the history of the stock market, and yet not one commentator saw it coming.

And yet, there were people who DID see it coming … and they made a fortune from it too.

How do we know this? Well, the 'unknown indicator' measures what options traders are doing. And the good news is that this report is not about how to trade options. All we're doing is following the lead of what options traders are betting on, and then applying that to simply trading stocks.

In the case of BSC, the indicator went nuts to the downside two weeks before BSC collapsed!

Someone, somewhere must have known something …

In this report you're going to learn how to spot another Bear Stearns, or more positively, how to spot a meteoric rise in a stock before it happens.

Whatever your trading experience or proficiency may be, this report will suit you. This is because my method is effective, simple and easy to apply.

I also want to re-emphasize, this is NOT a report on options! We will refer briefly to options during the report because part of our method relies on following what savvy options traders are doing, but this is specifically **not** an options trading method.

What we're doing is following a simple indicator that is derived from options transaction data. We combine this with a traditional chart pattern in order to trade stocks. As for the simple indicator, well, it's simple to use, but what's behind it is pretty sophisticated.

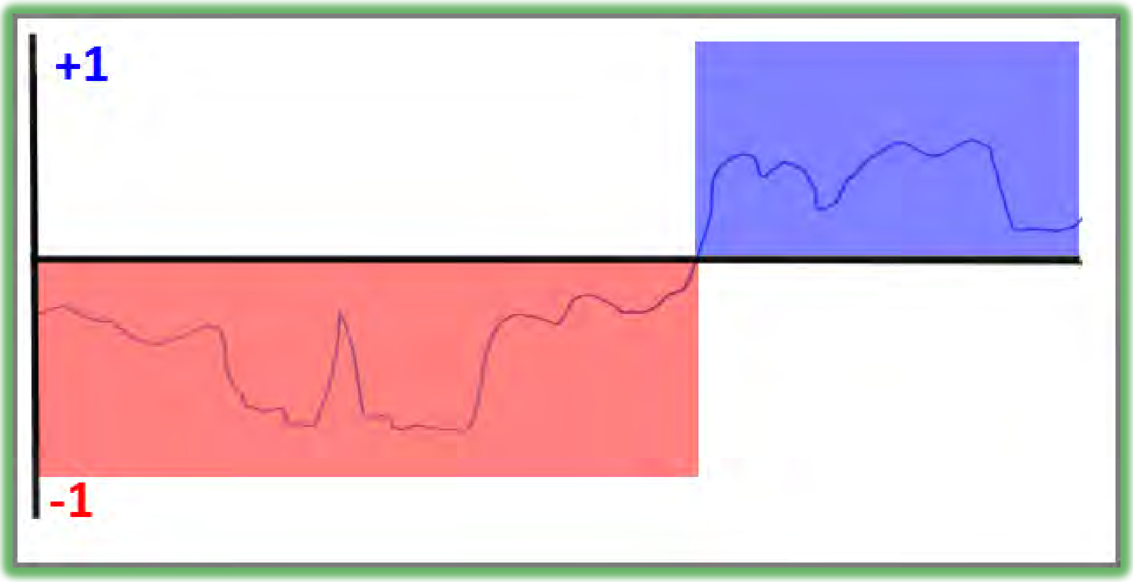
This indicator is known as the OVI.

Look at the diagram below - can you identify where this line is positive (above the horizontal line) or negative (below the horizontal line)? Of course you can!

- In the first two-thirds of the chart the indicator is negative. When it's like this for a few days we focus more on bearish chart patterns.
- In the last third of the chart the indicator is positive. When it's like this for a few days we focus more on bullish chart patterns.

It's that simple to read!

The OVI is a simple line:



Typically what we're looking for is for the indicator to correspond with a particular chart pattern. When the two match, then we have a potential trade.

Here's another example.

Goldman Sachs (GS) 2012-13

In this example you can see how the indicator was positive for over a month before GS first broke to the upside. This led to a move of over 50% in just six months. During this move there were several opportunities to buy the stock using our method and profiting from the fantastic move.


GS [Open: 149.41 High: 149.94 Low: 147.55 Close: 149.32] (+0.6%)
Perfect bull flag after
months of positive OVI
Original bull flag
150.00
140.00
130.00
120.00
110.00
100.00
Aug 1, 2012
Sep 3, 2012
Oct 1, 2012
Nov 1, 2012
Dec 3, 2012
Jan 1, 2013
Feb 1, 2013
Ovi - OVI Indicator [0.253]
0.8
0.6
0.4
0.2
0.0
CCVol - Color Coded Volume
10,000,000
8,000,000
6,000,000
4,000,000
2,000,000

Blackberry (BBRY) 2012

In the next example you can see how the OVI was negative preceding Blackberry's several breakouts to the downside. Within four months of the first obvious breakout the stock had halved in price meaning massive returns for short traders.



So now you've had a teaser of what's to come, here's a summary of my three steps.

1. You're going to learn about flags and breakouts.
2. You're going to learn how to use the OVI.
3. Finally you're going to outline the trading plan.

Before I start with Step One, I'll outline some of the facts that underpin my method and some of the challenges that traders face.

Important Facts

My approach to trading is enshrined in reality, based in fact and proven by objective statistics. No magical numbers or curve fitting. This gives me and my students a very focused approach.

- **Fact 1**
  More fortunes have been created from the stock market than any other financial instrument. It makes sense to focus our attention here.
- **Fact 2**
  There is one family of chart pattern that is responsible for more success than any other pattern or indicator. This pattern is easy to find and easy to trade with.
- **Fact 3**
  'Insiders' are consistently successful in the stock market. It makes sense to identify them and follow them.
- **Fact 4**
  No-one can consistently predict the market. You must only trade what you see.
- **Fact 5**
  You must always manage risk with a simple trading plan. The trading plan specifies where you enter, exit, and take profits.

These are important statements so let's examine each of them in turn:

Fact 1 – More fortunes are made in the stock market than any other instrument

Of course there are people who've made fortunes from forex, commodities, futures, options and other instruments. But many more fortunes have been made from stocks. Why? Because they're more accessible and because stocks, unlike any other instrument, give certain people at certain times an 'edge' that no other instrument can give. And that edge is what I call 'privileged' information.

In this report I'm going to show you how to follow the traders who appear to have some sort of privileged information, and how you can translate that into profitable trading for your account.

Fact 2 – One particular family of chart pattern has made many fortunes

Legendary traders like William O'Neil have celebrated a particular chart pattern that has been largely responsible for their own trading fortunes. This is the pattern I'm going to focus on in this report.

Fact 3 – Insiders make more profits more often!

This may seem like an obvious statement, but it's important to add that the term 'insiders' does not exclude those who have information gained and used completely legitimately.

It's a fact that some people are going to know what's going on with certain organisations at certain times. Sometimes this information is apparent because they have proximity to the business – for example a supplier or customer to the business has no illegal insider information per se, but has a general feel for how things are going for that corporation. Sometimes the information is more intimate with an insider connotation, for example in the case of information held only by the company's officers and close advisors.

I certainly do not advocate illegal insider trading, but it's a fact of life that it does go on. However, sometimes 'informed' trading occurs which is totally legitimate. Either way, the tell-tale signs of informed trading are easy to spot. And our job is to follow it because it leads to high probability trading profits.

You don't need to be an 'insider' or even have any information per se to make use of privileged information. Sometimes even those with supposed inside information get it wrong because they overestimate the impact their information may have. As such, illegal insider trading doesn't necessarily translate to profits anyway.

Suffice to say for now that our purposes, being able to observe transactions in the financial markets is far more important than the specific information on which they may be based.

Fact 4 – Don't predict, only trade what you see …

No-one can predict the market as in with a crystal ball. But what we can do is make educated decisions based on patterns when they start to move in our favour.

Fact 5 – Always trade with a proper plan

This should really read "trade with a robust trading plan". Not all trading plans are made equal. The right plan should embrace a tradeable chart pattern (like our preferred chart pattern), where you enter, where you exit, and where you take profits. It is simple but you have to have discipline to execute it over and over again.

Successful trading is all about having an edge or advantage. In this report I show you how to use a statistically proven advantage simply and effectively.

First, let's outline what our typical private investor is up against in the markets today. The average trader is faced with a multitude of challenges. Let's talk about some of those, and after that we can talk about how to make money from them.

Fund Management – A Cautionary Tale

I know an old lady who put her life savings of $1million in the charge of a reputable fund manager whose offices were in the Wall Street vicinity. The fund manager assured the lady that her money would be well diversified into blue chip companies spanning across the various stock market sectors.

And he did just that, true to his word. However, just one year later, that $1million fund was only worth $700,000, representing a 30% loss. The fund manager still got his fee, just no performance bonus.

Market Soothsayers

Have you ever watched the guest analysts on CNBC and Bloomberg TV, all making their predictions and peddling their wares? Have you ever noticed how wrong they get their predictions and yet still come back for more, time and time again? Have you noticed how they shamelessly forget about their countless wrong predictions and how the TV hosts never give them a grilling for it?! And yet, the one (out of ten!) predictions that they got vaguely right, they bang on about that solitary successful one for years!

Well, I have a saying for those frustrated mathematicians who make their livings out of making bold yet misjudged predictions: "***Even a broken clock is right twice a day***".

Black Boxes

Black boxes and automated systems are becoming an increasingly important part of the trading landscape. Ever increasing computer power now enables millions of simulations to be made to create automated trading systems.

The biggest problem with these systems is that the vast majority are 'over-optimized'. This means they have been fine-tuned with unrealistic and extreme settings that render the system worthless when activated in real time.

Most system developers do this unwittingly and it means that such systems are effectively optimized with the benefit of hindsight. In the real world we don't have the benefit of hindsight.

The key to a successful automated system is that it is 'robust' and not 'over-optimized'.

Robustness means that a system's performance stands up well to changes in variables and conditions.

Therefore it is imperative that a system is tested using institutional standards of statistical analysis. Sadly, the vast majority of systems you'll have ever seen are nowhere near these standards because it requires specialist knowledge to test in the correct manner. And that specialist knowledge takes time and costs a lot of money!

I may as well say it here and now. I brought in that specialist knowledge, and my automated systems conform to the highest institutional standards of analysis. My automated system is robust and is not over-optimized.

Only a few years ago I was actually averse to automated signals, but as technology has advanced, I began to find myself swimming against a large tide. Ultimately my institutional clients demanded that I automate my unique approach.

The results were a nice surprise. I discovered that my way of trading could be successful as a fully automated alert service, and not just as a guided discretionary system.

There are several measurement criteria that you must be aware of with automated trading systems, and I'll be discussing these in Chapter 5. It's important that the system is robust and has no particular weak areas.

For example, it's no good having a system where you have 90% winners if each win is only a tenth as big as each loss. You need a balance between win/loss ratio, and the average win size vs. average lose size. Also, you must consider how much drawdown the system historically demands as this will impact your ability to trade during the downswings.

Any trading system will go through the odd losing run, and it's important that when this happens it doesn't result in losses that are catastrophic to your account.

Tip Sheets

Most tip sheets don't last more than one year - fact! To be fair it's not all the fault of the tipster. You see, most tipsters do have their day in the sun, but that's just the point … they have their day in the sun. Then their day finishes. And that's the beginning of the end of their tip sheet.

Another issue with tip sheets is that they're impractical as most traders aren't necessarily in front of their PCs at the time when a call to action is made.

One of the main problems for private investors and traders is that they have a tendency to latch onto stock tips from any source that claims to have a unique edge. The fact is, however, that no-one really *knows* where a stock is going for sure, and this is particularly true when companies are announcing their results during the earnings season when *anything* can happen. Those who play earnings often get hurt badly when stocks jump against them. Others don't play earnings at all, and therefore may miss some of the stunning opportunities that can present themselves around that time.

What Traders Really Need

Traders need a clear and simple method that is based on sound principles.

And yet, trading seems full of complex theories and all kinds of irrelevant hocus-pocus.

Our way of trading focuses on these factors:

Earnings Season occurs every quarter where the majority of companies announce their results for the previous quarter, and is often coupled with a trading statement for the current quarter and beyond.

- A favoured chart pattern must be in place.
- An insight into what the insiders are doing.
- No earnings announcement likely to interfere with our trade.
- A clear and simple trading plan that specifies where to enter and exit the trade.
  The trading plan should embrace protecting profits early, and then hopefully windfall profits will follow if the markets trend in your favour.

Is all this possible for the regular home trader?
Absolutely YES, that's what this report is all about.

So let's see how we can achieve this.

- **What is the favoured chart pattern?**
  My favoured chart pattern is called a flag. There are two types of flag pattern, bullish and bearish. With bull flags we profit as the stock rises. With bear flags we profit as the stock falls.
  I also like to trade price breakouts from 'support' and 'resistance'. Support is like a floor formed by previous low prices, and resistance is like a ceiling formed by previous high prices. As a stock price breaks these levels we have the chance to make money.

- **Is it possible to profit from the breakout and keep risk low?**

  Yes, it is. By entering a trade that will only be triggered after the breakout occurs, you radically reduce your risk while still being able to participate in potential windfall profits.

- **Can you really see what the insiders have been up to?**

  Absolutely! Clever traders congregate in the options markets. My original training was in options so I know just where to look for them. This is where my OVI indicator is the game change – and this is now statistically proven by independent hedge fund analysts.

- **Can you identify stocks that are not about to report earnings?**

  Yes, you can easily identify stocks that have already reported earnings and disqualify those stocks that are about to make announcements. You can also find stocks that have no earnings in the imminent future. The more news there is in the recent past, the less likely there is of an upcoming potential nasty surprise. You can also identify stocks that have just reported earnings AND are forming a great pattern ... this is one of the most lucrative setups in the stock market.

- **Can a trading plan really be simple?**

  Yes. The components to it are:

  ✓ when to enter

  ✓ when to exit with a small loss

  ✓ when to take your profits.

I will teach you how to manage your trades so you avoid the mistake that most traders make – which is allowing profits to turn into losses. That will be a thing of the past!

I'll teach you exactly how to do that. I'll also teach you how to recognise the easiest and least risky patterns to trade.

Finally …

- **Can we find the opportunities easily?**

  Yes, we can identify these stocks with just a couple of clicks of the mouse:

  - ✓ with no scheduled news announcements in the near future
  - ✓ forming our favoured chart patterns
  - ✓ those where the insiders seem to be trading

The Three Easy Steps

So let me recap the three easy steps.

1. We trade with our favoured flag patterns and breakouts from support and resistance.
2. We follow what the insiders are trading by monitoring the unique OVI indicator.
3. We execute a simple trading plan that specifies where we enter and exit. We only enter when a breakout is occurring and we protect our profits early while in the hope that the trade will continue on to make a windfall. If it doesn't then at least we've protected our profit. Also, we avoid stocks that are about to make an earnings announcement.

First, let's summarize flag patterns ...

Flag Patterns

Many traders believe that everything you need to know about a security can be observed by looking at the charts.

The study of chart patterns is also known as 'technical analysis'. The idea is to recognise and interpret patterns in order to improve the odds of making a profit. The chart can tell you the story of the company's perception within the stock market so technical analysis can help you make your decisions with more precision, discipline, and can help you manage your money more effectively.

Technical analysis comes in two forms:

- **Price patterns** These are simply visible patterns of what is happening to the price of the security. There are only a couple of patterns that we're interested in for ***Flag Trading***, so that makes life easy for us.
- **Indicators** These are mathematical algorithms typically based on the stock price and volume of shares traded. These calculations enable traders to make interpretations. We won't be using these types of traditional indicators. Instead we'll be using my unique OVI indicator which is based on what the clever options traders are doing.

Over time the fluctuations of the share price will often form a recognisable pattern on the stock chart. There are many patterns that can occur and each one may give rise to a different interpretation of what may follow. As ***Flag Traders*** we're mainly interested in one type of pattern that involves trading in the direction of the main trend.

The type of pattern we like to see for our kind of trading is called a 'consolidating' chart pattern. Let's take a look at one so you can get the idea.

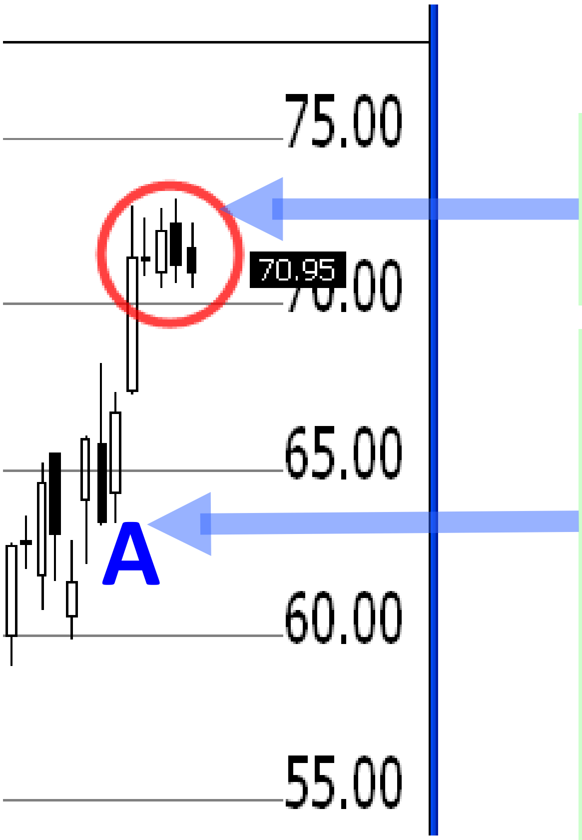
Consolidating chart pattern



This is an ideal chart for ***Flag Trading***. Do you see how the price rises sharply from point A? It resembles a flag pole. The steeply rising bars demonstrate that this stock has the capability of making sharp moves in price. We like that characteristic very much.

Then the stock slows down and moves sideways for a number of bars doesn't it? Let's focus in on this area of the chart to make it clearer.

Flag pattern close-up



This is the consolidation pattern where the stock stalls, and goes sideways. Notice also the length of the bars (the range) has fallen since the large rise.

Notice how the stock rises with long thrusting bars from around point **A**. Here the stock rises from around $64 to $73. That's a move of around $9 in just 2 days!

We're only just getting ready to make the trade around $73 if our other parameters (which you'll learn about in the video tutorials are in place. From the chart all we know is that we love the pattern and that if this stock can break upwards past this flag pattern then we'd like to profit from such a move.

From this point, as a ***Flag Trader***, we're only going to be involved if the stock makes a move to the upside. If the stock price declines, then we'll lose nothing. If it rises and continues to rise, then we'll make good profits.

So with the stock now at $74 and with all the other requirements in place we enter our Flag trade – don't worry, I will show you how in the online DVDs – and then we let nature take its course.

So, what happened next? …

Six days later …



Another 12 days later …



The example we've just been through shows a 'bull flag'. The pattern involved the main trend rising and then the flag pattern forming. We look to profit when the stock price rises above the flag pattern.

The opposite of a bull flag is a 'bear flag'. With bear flags the main trend will be falling and we look to profit as the stock price falls below the flag pattern.

Now I'm sure you're excited to discover exactly how you can regularly find these patterns, almost at will. Be assured, you're going to learn how you can find the opportunities for yourself when you go through the online DVDs and then use the website applications in the months and years to come.

Remember, we have two ways to find these patterns quickly.

First, within the classic ***FlagTrader*** website application you can filter for stocks that are forming flag patterns at the click of your mouse – how useful is that! All you have to do is make the appropriate selection and a list those stocks forming bull or bear flag patterns will appear underneath. This is the classic 'guided discretionary' method.

*We also have our more automated **OVIcopilot** software which simply publishes a trade that has been automatically generated by our algorithms, plus how to manage that trade each day. More about this in Chapter 5.*

For now, let's stay with the guided discretionary method using our classic FlagTrader filters. So your next step is to cherry pick the best looking patterns from the list you generate. In the online DVDs I teach you how to use your discretion to select those best looking patterns.



FlagTrader enables you to filter in seconds for OVI and flag combinations that create high probability trading opportunities.

For maximum ease, you can simply use my personal Fast Filters in a single click to identify stocks conforming to my favourite behaviour.

This is the most fun and rewarding way to trade. You make the ultimate choices, but you're not stuck to your computer once you've spent just a short time completing your homework and placing your trades. The rewards can be phenomenal, and the risk and stresses low if you follow exactly how I do it.

Flags come in various shapes and sizes. Some are more optimal than others. I teach all of that in fine detail in the FlagTrader online DVD-ROM course, so you can hone your discretion and learn to pick out the optimal patterns for making money consistently.

You can even make money trading when the stock price is falling too using the exact same mechanism in reverse. Instead of buying-then-selling, you can sell, then buy it back. This is known as 'shorting'.

The key is to ensure that you only get involved when the move happens in your favour. You don't buy or short in anticipation of a move, but you can enter a conditional order that says, "If the stock trades through a price, then buy it".

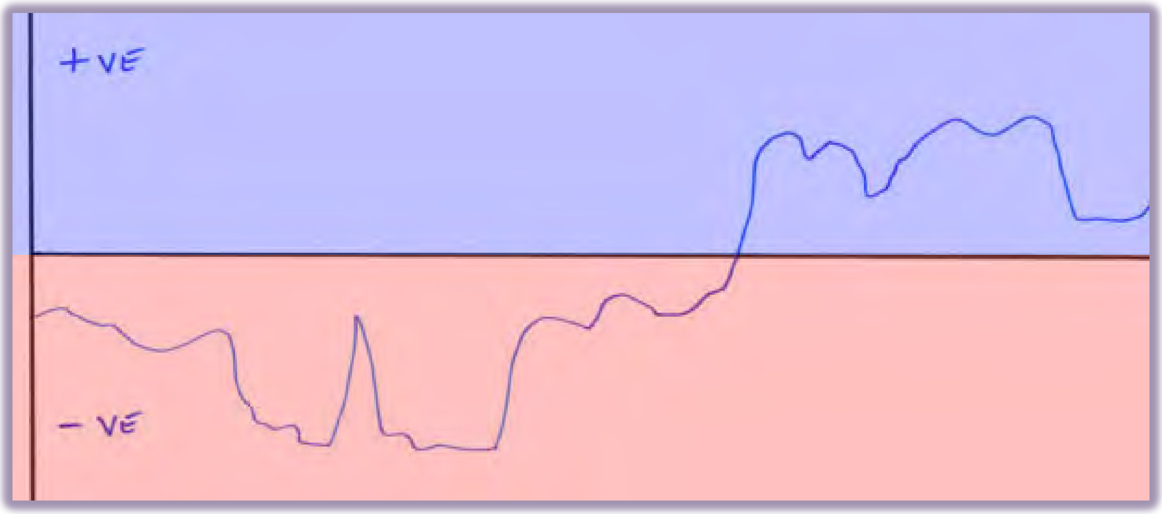
By using conditional orders you can control our involvement for only when the stock does what you want it to be doing whether you're buying or shorting.

Now let's look into my unique 'insider' indicator, the OVI ...

The OVI Indicator

No-one can predict 100% where the markets are going at any given time, but the OVI gives us an insight, especially during certain market setups ... like flag patterns! And that's what we need to become consistently great traders and investors. You can stick with just one inspired method like this and you'll make windfall profits safely.

On the face of it, the OVI is a simple line that oscillates between -1 and +1.



- When the OVI is positive we're more inclined to focus on buying stocks and when it's negative we're more inclined to focus on shorting stocks.
- The OVI is derived from options transaction data but you don't need to know anything about options to use it!
- Effectively the OVI is tracking what the smartest, savviest options traders are up to. When we combine this with specific chart patterns (flags!) we have a massive edge.

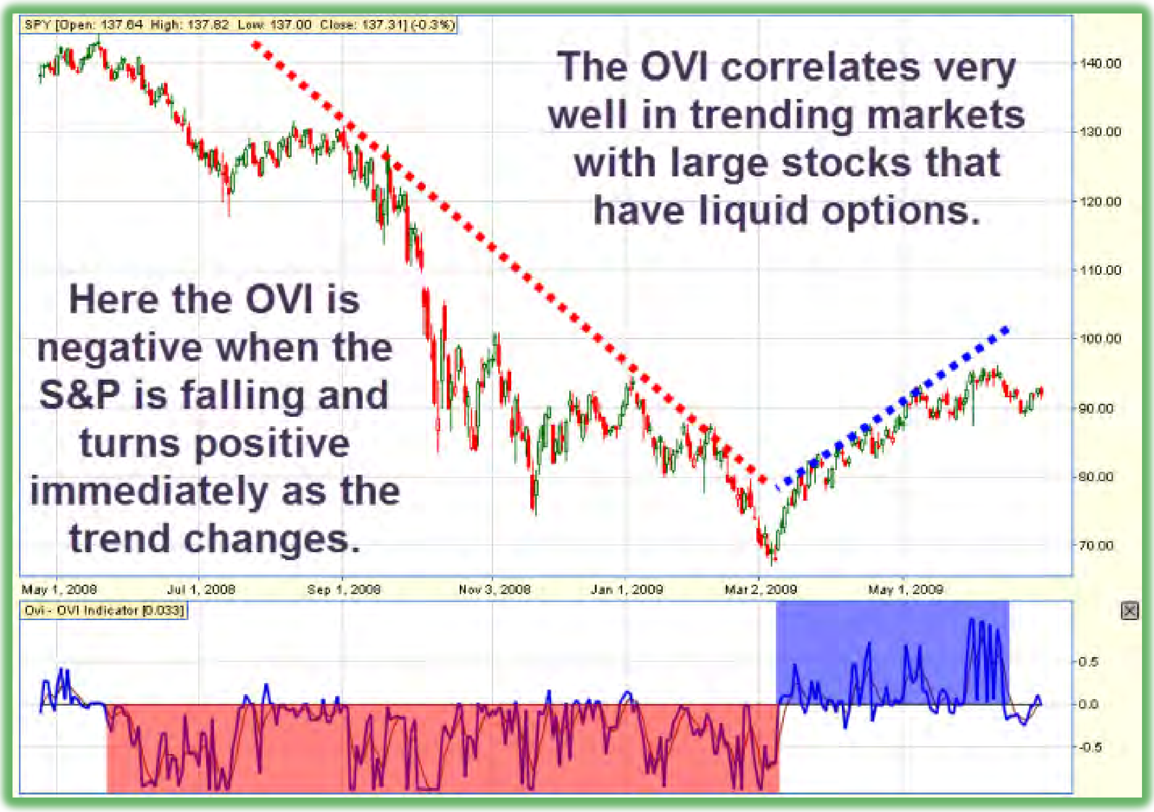
Why the OVI is Unique, and What it Can Do For You

The OVI reveals what the smartest investors are quietly getting up to, by analyzing the options transactions for each stock. No other indicator does this.

- You don't need to know anything about options to understand the OVI. It's just a line that oscillates between +1 and -1.
- The OVI is focused on actual transactions. Traditional price indicators (such as moving averages, MACD, RSI, Stochastics, Gann, Elliott, Fibonacci etc) are all derived from price and volume. But in my experience the price itself (including the pattern it's forming) and the actual transactions combine to make far superior indicators than those traditional derivatives of price and volume.
- What we need is a transaction-based indicator to supplement a price-based indicator. But we need something more pre-emptive than just looking at share volume. The OVI often moves decisively BEFORE the stock price breaks out. This is what gives us such a powerful edge.
- In this way, the OVI leads the market, whereas most traditional indicators lag the market. The OVI therefore gives you a huge advantage, especially prior to a potential price breakout. Traditional indicators are smoothed by way of averaging several days of data. This creates a lagging effect, which means they will tend to signify something only after the market has made its move. This is all very well in theory but not so good in practice where we need something more immediate.

In broad terms, the OVI tends to be positive when a market is trending up, and negative when it's trending down. The OVI typically works best with the larger stocks with liquid options, and has even worked very well with the SPY and QQQ ETFs for the S&P and Nasdaq respectively.

You can see this clearly with the S&P during a major reversal of trend:



<u>Bear Stearns (BSC) 2008</u>

Back to Bear Stearns, for a big stock with huge liquidity in its options like BSC, it's unusual for the OVI to plummet quite like this, so it's certainly on the radar now. However, one swallow doesn't make a summer and it's possible that this could be a blip. That said, if we break through this support then a short trade can be activated.



From the above chart we can see that BSC breaks support immediately, and as it approaches the next support level after three days the OVI is still pinned to its maximum negative reading. Now this is definitely unusual and if you haven't shorted it by now, then you sure do want to on the next break of support which is at the January low of $68.18.

What happens next is extraordinary. The stock breaks the January low and plunges to a low of $2.84 in just six days! There are a couple of things to note. First, the OVI is strongly negative as this happens and indeed almost two weeks beforehand.



The second thing to note is that the OVI comprehensively outperformed share volume as an alert that something was happening with the stock. Certainly there's nothing particularly unusual with volume in the chart below, but the OVI has been at its maximum negative reading for a few days already by the time the stock breaks $70.

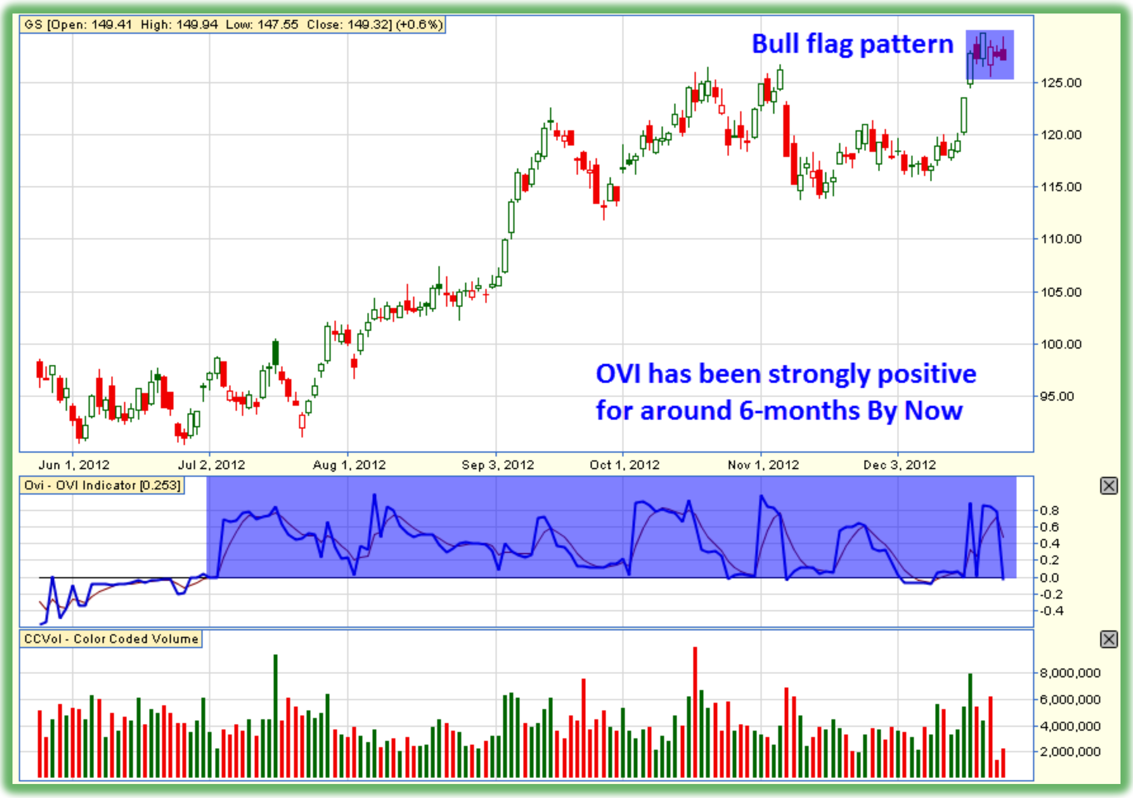


In the next chart we see how volume did rise dramatically, but only when the share price had begun to plummet and several days after the OVI had already alerted us.



The OVI With Bullish Stocks

As we've just seen, the OVI is often ahead of the stock in terms of a major breakout from a consolidation pattern. In the next chart we see GS forming a classic bull flag pattern just below $130. At the same time the OVI has been consistently and strongly positive for around six months by now – as signals go, that is a dead giveaway!



Now see what happened next ...

In just two months, GS soars by over $25 with the OVI in attendance all the way. It only takes one of these kinds of move to make a major difference to your trading performance.



We use the OVI in the context of a very safe trading plan, combining it with breakout patterns such as flags and sideways channels. This gives us an ideal way of using the OVI as a LEADING indicator, with maximum safety and the potential for windfall profits as you've just seen.

As you can see by now, the OVI is one of the most powerful indicators to help supercharge your trading profits. It works best with liquid stocks where there’s plenty of activity and will give you the edge you need.

There’s one piece of our puzzle left, and that’s the trading plan ...

The Classic Trading Plan

In this chapter I'll walk you through the 'classic' trading plan for flag patterns when you're using our unique filters to find them yourself. With our automated version we use a slightly different technique for managing trades. More about that in Chapter 5.

The Classic Trading Plan for Bull Flags

Our basic trading plan consists of four broad steps:

1. Enter the trade.
2. Set the first profit target (P1).
3. Exit with either a small loss; or
   Partial exit at the first profit target (P1)*.
4. If you reached the first profit target, then exit the second half of the trade at the second profit target.

*** Some traders opt to raise their stop at the P1 level, rather than taking partial profits.**

In this chapter I'll outline the basics of:

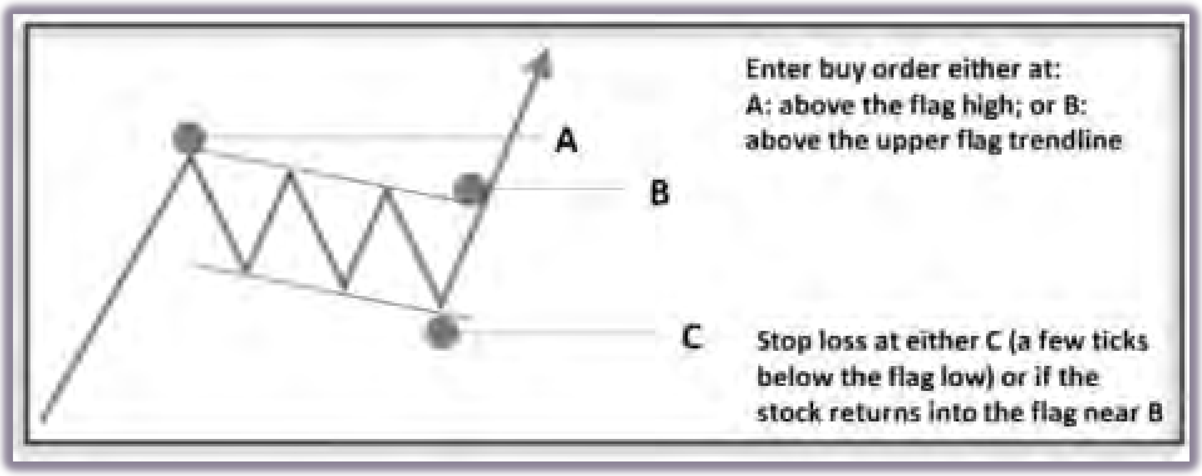
- Entry
- Setting the initial stop loss
- Setting the first profit target
- How to exit the second half of our trade

We'll cover this plan for bull flags.

Entry

The bull flag potentially has two resistance levels. If the bull flag has consolidated sideways, then the only possible entry point is at Level A, just above the flag high.

If the bull flag has retraced downwards, then the most recent point of the upper trendline is the other. Level B is just above this.



We can enter our buy stop-limit order at Level A or Level B. Level A is more conservative as it is higher. Because it is above the highest resistance level for the entire pattern, if the stock price reaches it, the chances of a double top occurring are lower.

In rampant bullish trending markets Level B would be appropriate as a more aggressive entry point.

If the top of the flag is $50, then Level A will be slightly above this, say around $50.17.

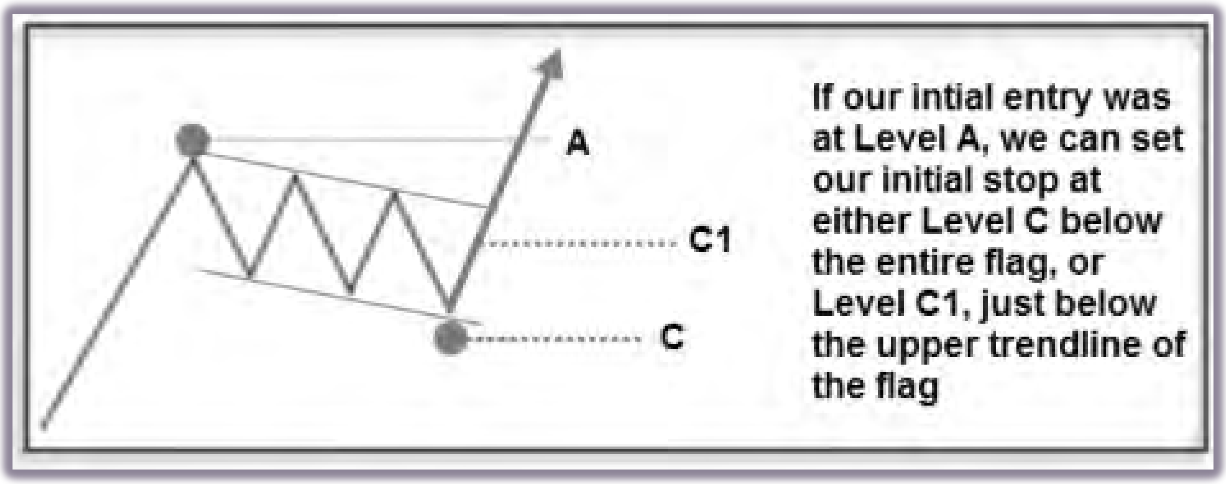
Initial Stop Loss

With a tight, neat bull flag we typically place our initial stop loss under the base of the consolidation at Level C (see below).

There is an alternative however, especially where the flag is not so tight.

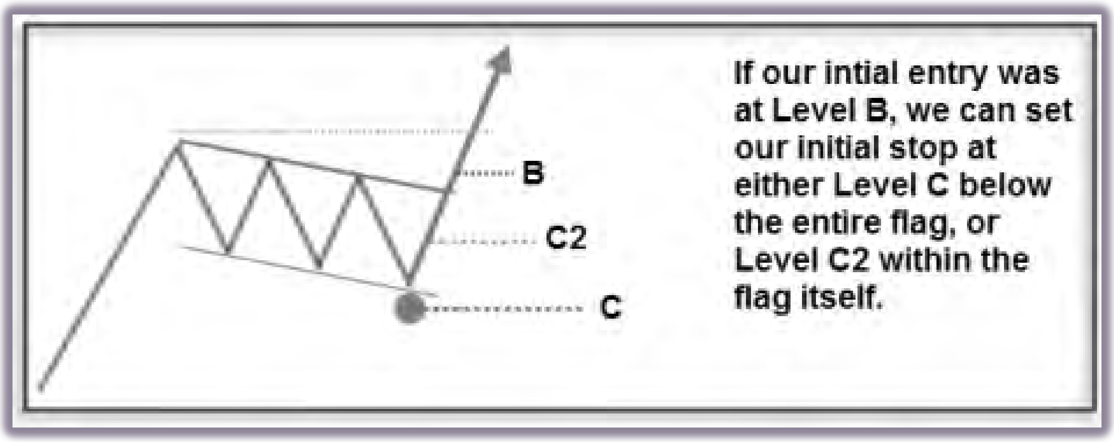
If our entry is at Level A (just above the entire pattern) then you could have a stop just below Level B at Level C1. So, if a stock price breaks out to trigger our trade at Level A, only to reverse back into the flag consolidation, then you could have your initial stop loss within the consolidation itself around Level C1.

Having the stop here means you bear less risk on the trade, but because your stop is now nearer your entry point, your risk of being stopped out in the first place is higher.



I typically prefer to enter at Level A, and provided the flag is tight, I'm usually ok with my initial stop at Level C.

If your entry is at Level B (just above the upper trendline of the flag) then you can have your initial stop loss either just below the base (Level C), or within the actual flag itself – just below the halfway point of the consolidation around Level C2 (see below).



First Profit Target

The first profit target is where we exit half our stake, taking profits on that portion of the trade**. When we do this we'll also have to adjust the initial stop. The remaining half of the trade is still active as the price hopefully continues trending in our favor.

*** Note, some traders prefer to simply adjust their stop to breakeven and make it a trailing stop once the P1 level has been reached.*

<u>Entering at Level A</u>

If we enter the trade at Level A (just above the very top of the flag), we take the length of the flagpole, and extend it upwards by 0.382 beyond the high point of the flag pattern. Then round-down as appropriate to set an easier target to reach.
In the next diagram our flagpole is 8 points. So the move we're looking for beyond the breakout is:

8.00 x 0.382 = 3.06

If our top-of-flag resistance is at $50, then we add 3.06 to this figure to calculate our P1:

3.06 + 50 = 53.06

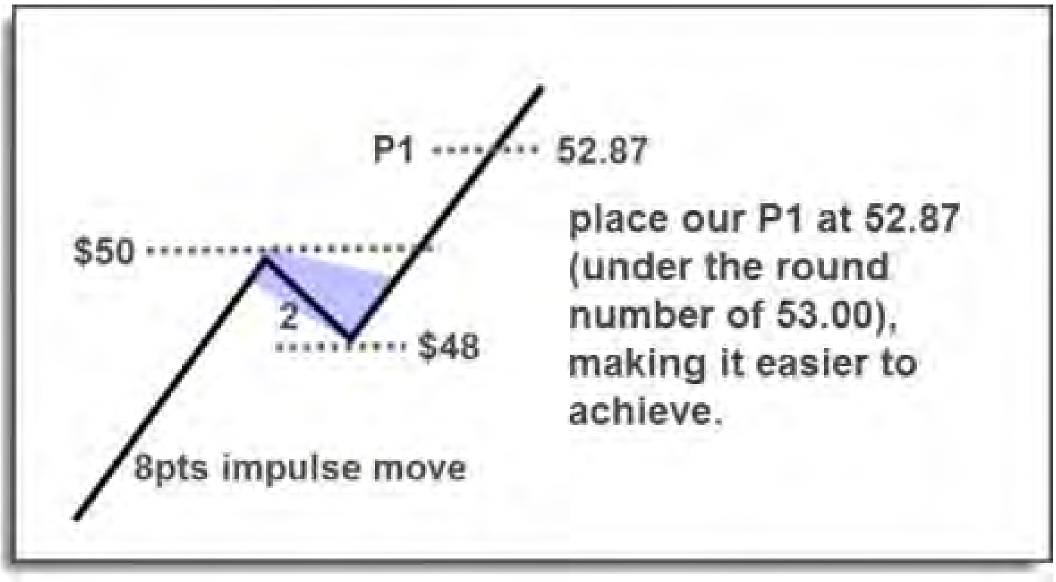
But let's make our target easier to reach by setting it under the round number of $53.00, say $52.87.

Remember, we can always bring our P1 in closer and therefore easier to achieve.
In this example below, we have a stock that moves up $8 to a high of $50. The stock then retraces by $2 to $48. This $2 retracement could have taken the form of a flag. As the stock then resumes its ascent, our buy order is activated as it trades through our stated entry point of $50.17.

With P1 at $52.87, the amount of our first profit is:

52.87 – 50.17 = 2.70

Remember, the first profit is designed to be achievable, and it's only part of your potential profit in this trade. Bagging the first profit secures a quick reward for us that also enables us to modify our initial stop loss into a trailing stop, thereby protecting what we already have.



Entering at Level B

Looking at the next diagram, if you entered your trade at Level B (just above the flag's upper trendline), then you can use the same P1 as we did above, or you could bring the calculated P1 target nearer to our Level B entry point.

For our entry at Level B we'll use the same length of flagpole at 8 points. So the move we're looking for beyond the breakout is the same as before:

8.00 x 0.382 = 3.06

If the most recent point of the flag's upper trendline resistance is at $49.00, then we can add 3.06 to this figure to calculate our P1:

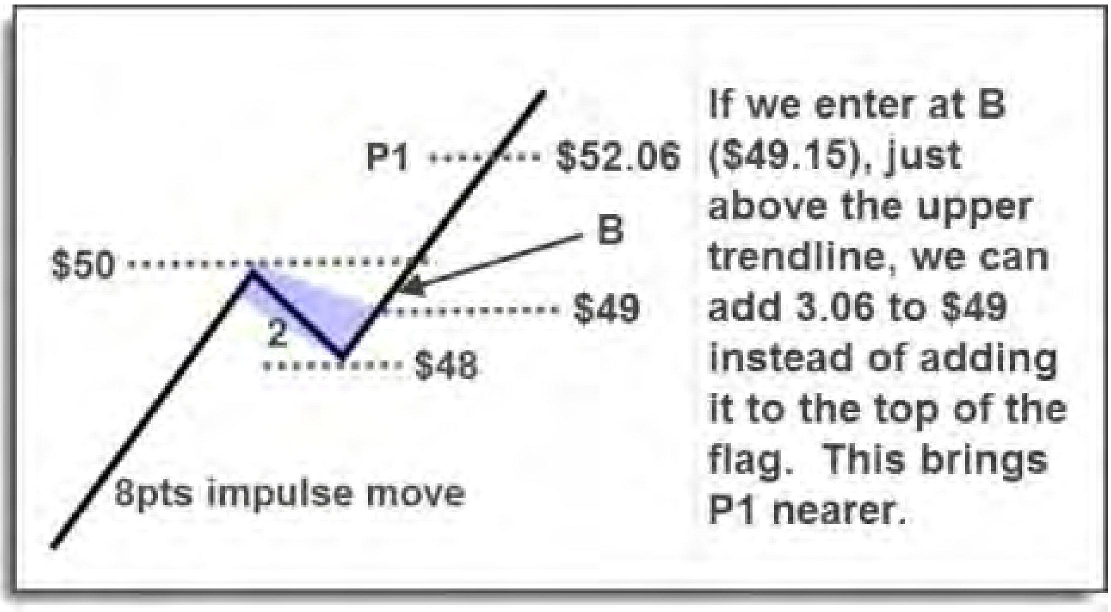
3.06 + 49.00 = 52.06

Using the same example, the only difference now is that we're entering at Level B, just above $49.00 (say at $49.15), rather than Level A ($50.17) which was just above the top of the entire flag pattern.

As the stock then resumes its ascent, our buy order is activated as it trades through our stated entry point of say $49.15.

With P1 at $52.06, the amount of our first profit is:

52.06 – 49.15 = 2.91



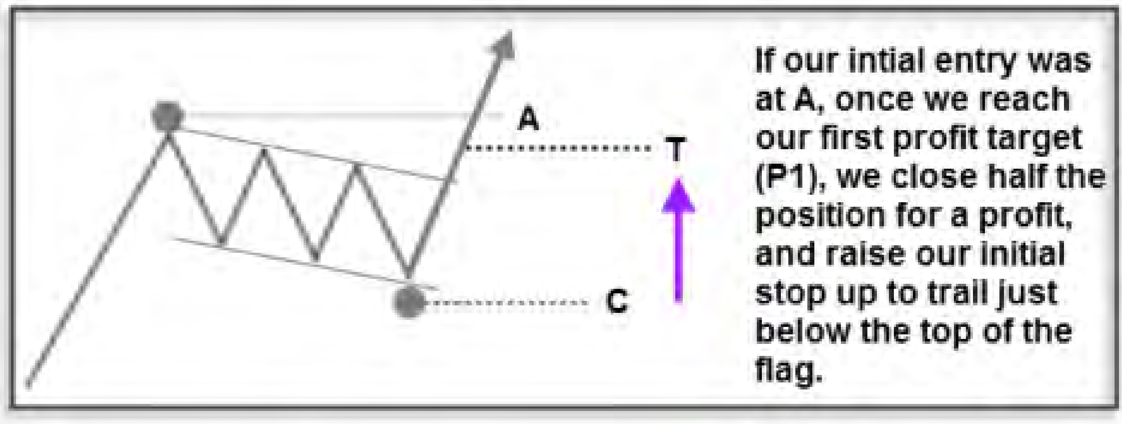
Adjusting the Initial Stop

Now that we've secured our first profit, we need to adjust our initial stop.

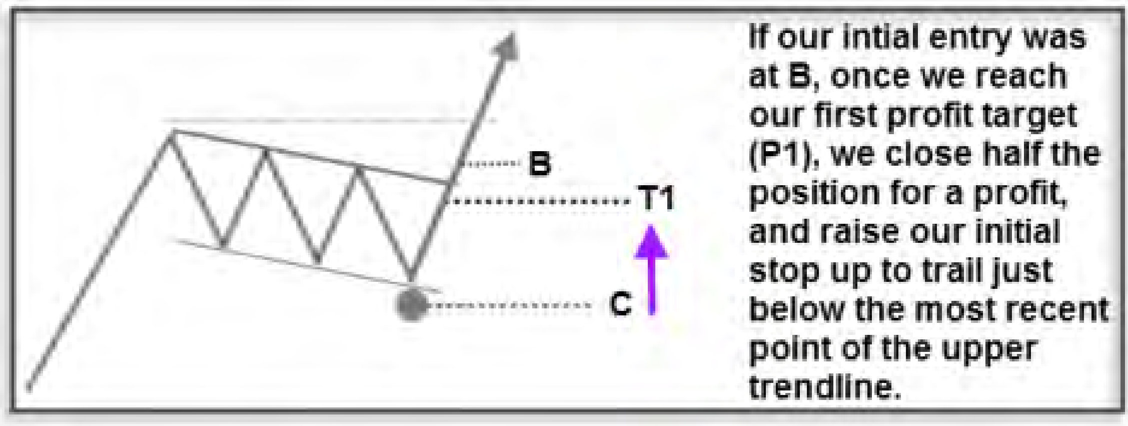
Remember, if we bought 200 shares in the first place, our initial stop would be with respect to those 200. Once we close half our position (100 shares) the stop now only relates to our remaining 100 still open.

So now we need to raise the level of the stop so it's at or just below our initial entry point. Placing it just below our entry point enables the stock price to test the breakout level without stopping us out.

If our initial entry point was at Level A (above the entire flag) then we raise the stop to trail just below this at Level T.



If our initial entry point was at Level B (above the most recent point of the upper trendline of the flag) then we raise the stop to trail just below this at Level T1.



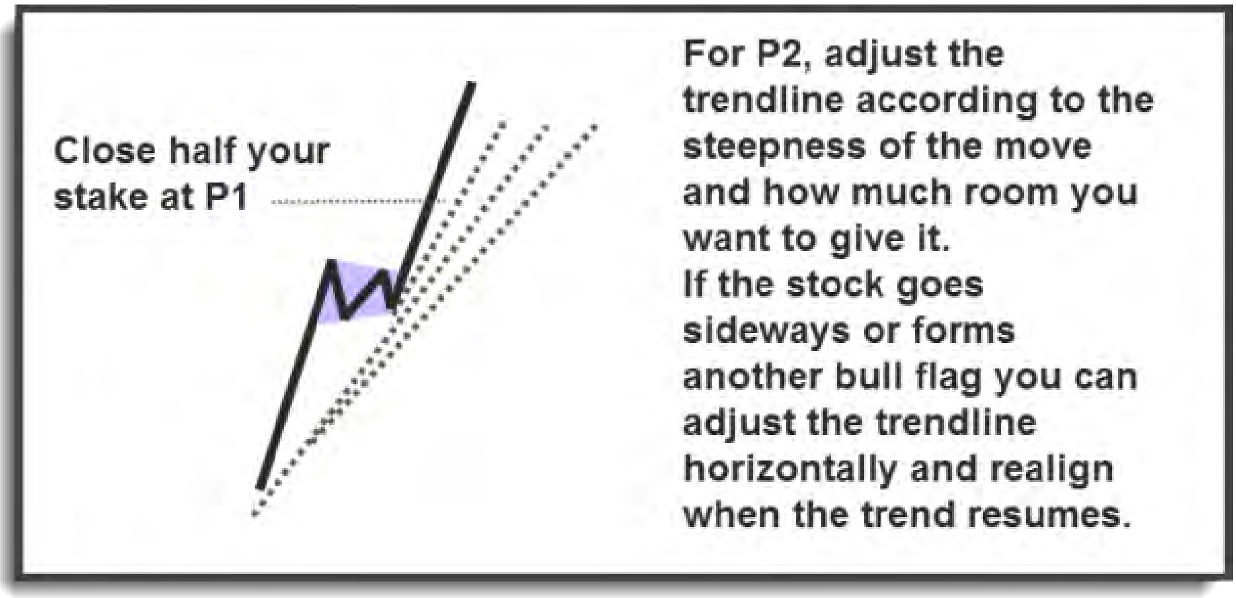
Taking the Second Profit (P2)

Now it's just a matter of managing the second half of the trade with a trailing stop.

From here, if the stock price reverses to below our entry point, hitting our adjusted stop, we'd make a tiny loss (or breakeven depending on where you adjusted it to) on the second half of the trade, but overall we're up because we've already closed the first half of our position at the P1 target.

If the price meanders sideways our adjusted stop holds firm horizontally until the stock either breaks down or resumes the uptrend.

If the price resumes the uptrend then we manage this with a simple rising trendline.



We draw a rising trendline under the bar lows as higher lows are made.

There is some room for discretion when it comes to managing your P2 profits with the rising trendline. If the stock price rises beyond P1 and then starts to form what might become another bull flag, you may want to adjust the trendline horizontally for a while to see if the price can make another burst upwards.

Trends occur in steps and flags. Our windfalls depend on riding trends, so we need to give ourselves a chance to do so without being stopped out prematurely. At the same time, safety is our mantra.

Furthermore, you can always add another entry to each new flag and repeat the trading plan, thereby adding to your position in a very safe way, taking P1 targets each time and potentially having several P2s running all at the same time.

Prevailing market conditions will have a bearing on how aggressively you manage your trendline for P2. In a choppy market you may keep it tight, especially if the stock rises very steeply before retracing just as severely.

In a low volatility, stable, trending market you may want to keep the trendline quite loose in order to give the stock price room to keep trending. It's in trending markets where we make our windfall profits and once you've been trading this method for a while, you'll get a feel for which type of market we're in.

Also, by trading in this way you only need one or two rockets to really boost your batting averages. If you just stick with prime OVI-Flag combinations you'll have fewer trades, but the quality will be phenomenal, and you'll have more chance of picking up one of these …

Bear Flags and Channels

For bear flags the trading plan is identical but in the opposite direction.

We also use very similar trading plans for bullish channel breakouts and bearish channel breakouts.

In this way we have a consistent methodology.

Combining the OVI with these patterns is one of the most powerful trading methods I've ever encountered, and one that is very easy on your trading psychology.

You can see a full demonstration of the OVI-FlagTrader combination on our exclusive 'Global Release' webinar. Remember, I'll also be revealing the new **OVIcopilot** which is our independently tested automated trading system, allowing you to benefit from our method in literally minutes each day.

Simply attend my webinar that you've registered for, and learn how you can start trading with the OVI and flags immediately.

Automated Trading

So far in this report I've been talking about 'guided discretionary' trading with our OVI-Flag method. Ours is a low risk / high reward style of trading that requires several factors to be in your favor in order for a trade to be triggered. This is exactly how a robust trading plan should be.

- Guided discretionary trading is where the parameters are well defined but it's ultimately you who makes the final decision once you've used the filters. This makes it challenging to back-test objectively because different traders may produce varying results due to the partial subjectivity of their decision-making.
- Automated trading is where the algorithm objectively produces the signal for entry and exit. Automated trading is not 'advice' per se as there is no human input beyond the algorithm itself. This lends itself to limitless back-testing as it is entirely objective.

As computer power has increased, algorithmic trading has become more sophisticated and institutions now require greater levels of automation regarding trading signals, with statistical evidence endorsing the strategy.

Due to its uniqueness, the OVI has attracted a lot of attention from individual professional traders, and as a result we have had to rise to the challenge of providing more automation.

Key Requirements For An Automated Trading System

A highly skilled individual trader should be able to outperform an automated system. This is because a skilled trader can use discretion to their advantage, while an automated system has no discretion beyond its algorithms. By contrast, an unskilled individual trader is likely to be outperformed by an automated system over time.

Some people follow automated systems to the letter and others cherry pick the trades – which may prove to be inferior or superior to strictly adhering to the system.

An automated system should have statistical proof and relevance due to its historical results. While this is no guarantee of future performance, if the system is proven over enough trades and varying market conditions then it can give a measure of confidence for its followers.

Here are the main factors you must look out for with an automated system:

- The number of winners vs. losers
- Average win vs. average loss per trade
- Profit factor

These three factors are related and should not be considered only in isolation from each other

- Average profit per trade
- Trade frequency
- Maximum drawdown
- Performance over time

Winners vs. losers (hit rate)

Naturally, it's preferable that there are more winners vs. losers, but a great system can actually have quite low levels of 35% winners provided the average win is far greater than the average loss. Different traders have different comfort levels. Some are comfortable with a low percentage of winners with a high win-per-trade, and others prefer to have more winners than losers with a lower win-per-trade. Ultimately you cannot look at this in isolation. You need to balance the hit rate against the ...

Average win vs. average loss

Typically we would prefer the average win to be a good deal greater than the average loss, but not if we only win a tiny fraction of the time. Similarly it wouldn't do for the average win to be dwarfed by the average loss even if you have many more winners than losers. Many trading systems fool traders into their high win ratio while

failing to alert their traders about the low average win compared to average loss per trade.

Here's a quick test: which system do you prefer?

(i) 90% winners, with each winner being 10 points and each loss being 80 points; or

(ii) 50% winners with each winner being 90 points and each loss being 80 points?

Neither are great, but with System (i) the nine little wins are almost cancelled out by just one big loss. The system is therefore very sensitive. Just one extra loss would result in a catastrophe for the system.

System (ii) is more balanced and therefore less sensitive to one thing going wrong causing a catastrophe.

Ultimately I prefer a system that is balanced. By this, I want more wins vs. losses, AND I want the average win to be greater than the average loss. This way, I am better protected from a catastrophe if something goes wrong.

Profit factor

Profit factor is a performance measure for a trading system which combines the number of winners and losers with the average win and loss.

Profit factor is calculated by dividing the gross winnings by the gross losses. 1.28 is considered a bare minimum requirement to account for the risk free (90-day T-Bill) rate of return, risk premium (that stocks are more risky than T-Bills), opportunity cost, and time.

Anything above 1.5 is considered decent, but we aspire for more, and we do achieve more, while not compromising on our requirement for low risk.

Average profit per trade

This ties into how many trades you're making with this system, but you want to ensure that the system is generating enough profit per trade to cover your trading costs and slippage. There's no point in having 90% winners if they're so small they barely cover your costs.

Trade frequency

This is somewhat subjective, but even if you're only making one new trade per week, depending on the system's ability to run its winners, you could still have several trades open at any one time that still need managing every day. Also, there will be relatively quiet times where the markets are producing no trades for your system, and then all of a sudden, several new trades pop up at the same time.

Maximum drawdown

Drawdown is defined as the peak-to-trough decline during a specific period of investment. It can be quoted as an amount or a percentage.

Maximum drawdown measures the largest single drop from peak to trough over a time series before a new peak is achieved. As such it is an indication of risk.

The formula for maximum drawdown percentage is:

(Peak value before largest drop – Lowest value before new high) / Peak value before largest drop

Even the best systems will have a losing streak at some point. If that streak occurs at the very beginning of your journey, you must have enough in your account to navigate through it.

Ultimately I don't want a maximum drawdown to be more than 15%. The S&P Index took a drawdown of over 56.78% during 2008-09, which is far too much for my liking. A low maximum drawdown is essential if you're using leverage such as margin, or if you're trading CFDs or spread-betting.

The starting date for your automated trading experience does involve some degree of luck. If you start just at the beginning of a winning streak, then your account is likely never to dip into the red. If you start it at the beginning of a losing streak, then the system must be able to cope with that without destroying your account. That will be partly a function of your account being adequately resourced. I'm conservative by nature and am predisposed to over-fund my account. This is something we'll talk about during the webinar and beyond.

Performance over time

You need to ensure that the system has enough statistical evidence to give you confidence in it moving forward in time. This is a function of the number of trades, the amount of time and varying market conditions.

Number of trades

I've read that the number of trades that will give statistical relevance to a system can be anything from 30 to 1,000. 30 is too low. The more trades included in the analysis, the more statistically relevant the system will be. Our systems have been rigorously tested, with versions into the thousands of trades, and then being trimmed to several hundred as parameters become constrained. This gives us confidence in our statistics where we have tested millions of permutations and combinations.

Time

Five years is adequate provided the markets have experienced bullish, bearish and sideways periods. Ten years is even better if the data is relevant and the analysis not 'over-optimized'.

Varying market conditions

In 2008 the stock market suffered one of its biggest crashes in history. It bounced back in 2009 and then moved sideways from 2010 to 2011. We then had a predominantly bullish market from 2012 into 2013 and then 2014.

Our systems are tested during this time period where the market changed its personality several times. If a system performs well in that period from 2003 to 2013, then I personally have confidence in it, provided there has been no curve fitting.

Our latest system was co-developed by a team of independent hedge fund quantitative analysts. In every aspect of the development we sacrificed performance in favour of logic and retaining a robust approach. The performance is still excellent and as a result of our diligence, has excellent prospects to continue.

Equity Curve

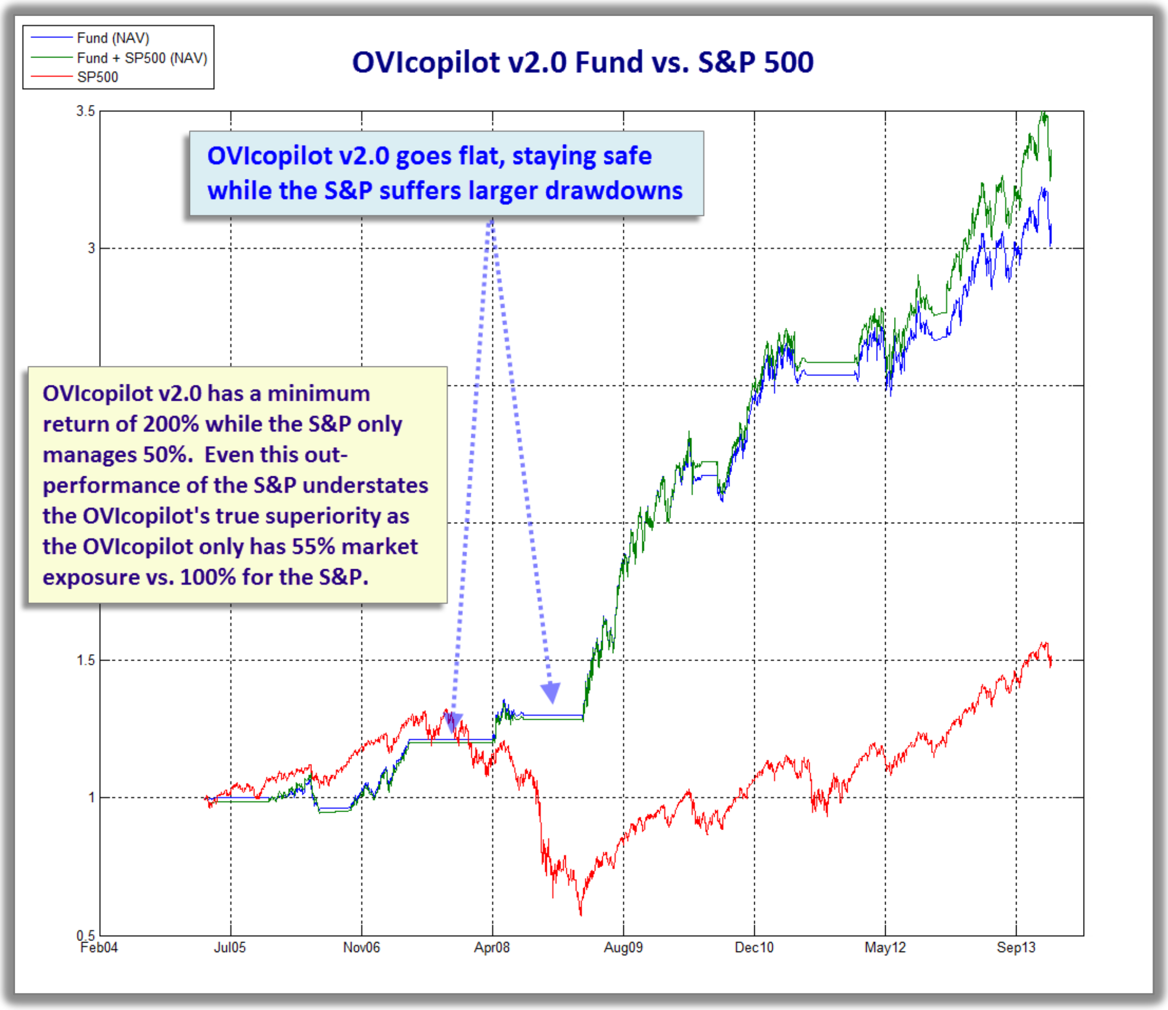
An equity curve is a visual representation of how a trading account performs over time.

A smooth 45 degree line rising upwards from left to right is unrealistic. In real life the market ebbs and flows, sometimes dramatically.

The key to a healthy equity curve is that it should not have scary looking drops. Flat portions are fine as this means the system is keeping you out of the market during unfavorable conditions. This is the sign of a good system.

The chart below shows the OVIcopilot v2.0 equity curve (blue and green) compared with the S&P 500 Index (red). The green and blue lines only differ in that the green deploys surplus funds in our OVI Sentiment Index when not fully invested in stocks.

Notice how the OVI system totally averts the 2008-09 crash, but fully participates in the big recovery from March 2009 onwards. The OVIcopilot v2.0 system is far superior to the S&P 500 Index in every conceivable way.



The above chart shows the OVIcopilot's profitability outperforms the S&P by 4-times. This is actually an understatement because the OVIcopilot has on average only 55% market exposure, while the S&P Index has 100% exposure.

Parameters for Automated vs. Discretionary Systems

With our guided discretionary method, most of the hard work is done for you, but there is some learning required on your part to train your eyes to distinguish between a couple of specific patterns and also execute the trading plan correctly. This visual 'eyeballing' is straightforward and becomes second nature very quickly, which is why we have such a significant following. With the better traders this leads to superior performance.

With an automated system the algorithms effectively make the decisions for you if you choose to follow them religiously. With any automated system you will see the disclaimer to the effect of "past performance is no guarantee of future returns ...", which reflects the fact that markets aren't always predictable.

This does not prevent the institutions from pursuing the automated model, but they insist that the system must have statistical validity over time and different market conditions.

With an automated system you are not being given advice per se. The signals are generated entirely by algorithms. This has advantages and disadvantages.

Assuming the system is properly conceived, the advantages include:

- No decision-making on your part
- Simple and quick to use
- Entirely objective trading
- Statistically proven over time
- Best for non-skilled or undisciplined traders provided they stick to the signals.

The disadvantages are:

- Ceding control to the system

- Highly skilled traders should be able to outperform an automated system albeit with more effort.

Key differences between our automated and discretionary trading plans

During our extensive research into automation we needed to create absolute objectivity. We tested literally millions of combinations and permutations using institutional standards of robustness to ensure we were never curve-fitting the outcomes.

One consequence is that we have made several major improvements to the FlagTrader guided discretionary system that was already working very well for our traders:

- A superior algorithm for the flags
- Enhanced OVI filters
- A new trading plan based on 'Average True Range' multiples for the initial stop and profit taking. In the automated world we do not take partial profits at P1. Rather, once P1 is reached, the initial stop turns into a trailing stop.
  (You can also use this approach with the discretionary method, but less disciplined traders may choose not to implement it)
  Average True Range (ATR) is an objective measure of price volatility over a period of time. This makes it ideal to use for calculating potential profit targets and stops.

Account size and trade size

Not many systems developers will tell you this, but there are significant differences for those trading large size and those trading small size. With smaller sized accounts it's more challenging to trade the larger priced stocks. Larger account sizes will typically outperform smaller account sizes in the automated world, while the opposite is more common in the guided discretionary world.

<u>Dollars per trade vs. Shares per trade</u>

Let's say you're able to allocate $1,000 per trade.

- With a share price of $500.01, you will only be able to trade one share of that stock, meaning only one half of your permitted $1,000 per trade.
- With a share price of $10.00, you'll be able to trade 100 shares and complete the full allocation of $1,000 for that trade.

In this scenario your system is biased to lower priced stocks because you can allocate close to your maximum size each time, while with the higher priced stocks you may get a much smaller fraction of your maximum size filled. With large accounts this effect is reduced.

Now let's say your system is on the basis of trading a set number of shares per trade.

- GOOG is $800 per share while BAC is $10 per share.

In this scenario your system is biased to higher priced stocks.

These factors need to be understood and we have found quite different results even when all other parameters are identical. Ultimately it is better practice to trade on the basis of dollars per trade.

The key is to ensure that the system is robust in its approach and has no serious weak links in terms of excessive drawdowns that could destabilize the overall performance, even if some trades may have more impact than others.

Most trading systems you'll ever see have been over-optimized or curve-fitted, which means they will not be robust. It's an easy mistake to make unless you are highly trained in statistical mathematics, or hire the right people to ensure the system is sound.

I took my system to a team of independent hedge fund analysts who helped me improve my methods to create a thoroughly robust trading system that I can use with confidence. I will be making this system available to you too.

Our Backtested Results

With any investment there is always a balance between risk and reward. And as you've seen any system worth its salt must be clear as to whom it is suitable for.

As such we have created different versions of the same theme to suit different account sizes and types. This means, whatever your status we have something that will be suitable for you.

This is one of the things we'll be discussing during my live webinar for which you've already registered.

For now what I will say is that our systems have a healthy balance between:

Winners vs. losers (hit rate) *and* Average profit vs. average loss.

Our systems all have healthy profit factors and we also focus on low drawdowns.

We have tested several automated systems – here's just one of them, with no compounding and no leverage:

Winners vs. losers:	**66%**
Average win vs. average loss:	**123%**
Net profit on invested funds:	**900% ***
Profit factor:	**4.31**
Maximum drawdown	**10.93%**
Trade Execution average frequency	**0.72 per week**

*** Over a 10-year period. With compounding and basic margin this figure improves markedly.**

These are phenomenal figures, combining safety with great performance.

During our webinar I will outline the performance of these in full. Our method is to combine the OVI with flag/breakout patterns and volume in order to produce a safe, high probability trading system that has been proven with statistical validity over time.

The system is called the **OVIcopilot v2.0** and very soon you'll see just how good it is, regardless of your account size or which type of trading account you have.

I'll see you on the webinar!

Bye for now.